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"Building Our Future: Increasing Housing Supply in America"

Chairman Flood, Ranking Member Cleaver and Members of the Subcommittee, thank you for the opportunity to testify and share my perspectives on increasing housing supply, and particularly workforce housing[1], in the United States.

My name is Paul Compton and I have practiced law at the intersection of real estate, banking, tax, securities and affordable housing for more than 30 years. After my Senate confirmation in a bipartisan vote in 2017, until 2020, I served as General Counsel of HUD under Secretary Ben Carson. Since that time I have returned to private law practice in Birmingham, Alabama, continuing to focus on affordable housing and commercial real estate.

In July 2024 I had the privilege of testifying before this Committee concerning cutting through government red tape in order to increase the supply and affordability of housing. I appreciate this opportunity to follow up on that testimony.

In that testimony, I expressed my view that while overregulation, particularly at the state and local level, is the cause of high housing prices, the solution is the need to reestablish checks and balances, especially at the state and local level, to continuous growth over the past 40 years in housing-related regulation. Numerous studies, but in particular a comprehensive review of scholarship on regulation and housing supply conducted for the National Bureau of Economic Research more than ten years ago by Joseph Gyourko and Raven Molloy, in my mind, definitely establishes several facts:

A. The real, that is, inflation adjusted, cost of housing construction has not meaningfully increased over the past 40 years.

[1] There is not a federal definition of "workforce housing". It is commonly used but could mean many things. Sometimes it is synonymous with affordable housing and, indeed, sometimes uses the same HUD rent levels, which are usually 60% or less of median income. However, more commonly, it is intended to refer to median income levels of 80% to 120%. Most often, it signifies housing that would be affordable by middle and lower-middle class working persons. In this respect, it is usually intended to mark a distinction from housing that is supported by HUD Section 8 project-based assistance or housing choice vouchers or similar programs from the United States Department of Agriculture or public housing.

B. The real cost of housing has substantially outstripped inflation over that period.

C. The core components of that excess cost are land costs, indirectly driven by land use regulation, the direct cost of regulation and the indirect cost of regulation in terms of time.

In my prior testimony, I noted my view that there are hundreds of federal government red tape impediments and tens of thousands of state and local ones (some spurred by federal requirements), which like the tiny ropes of Lilliputians in *Gulliver's Travels*, ensnare and keep flat on its back market forces and entrepreneurship which could otherwise make housing much more abundant and less costly in the United States. I believe that Jonathan Swift's classic, *Gulliver's Travels*, remains as accurate a political satire today as it was when written almost 300 years ago. And the problems America faces in this case are as old as bureaucracy.

From community to community, and indeed even from federal agency to federal agency involved in housing programs, there is great variation in the nature of regulation. How Massachusetts is regulating housing is different from California, which is certainly different from Texas. Moreover, how the United States Department of Agriculture is regulating its housing programs is different in many respects from the way that the United States Department of Housing and Urban Development is regulating its. One result of this is that the housing market, particularly for single-family and smaller multifamily developments, is incredibly localized in nature.

Thus, I believe that the first conclusion for this Committee is that there is not one or even two or three or four or five answers to this problem. Instead, I believe that it first must be viewed systemically; that is, how can our overall governing structures be adjusted such that there is not a continuing bias to more regulation?

Second, we must look, aggressively, for each opportunity to pare back regulations, even if in some cases it is possible to concede that they are helpful but on the other hand they exert an overall drag which is against the public interest. In this respect, I note that the same NBER paper which I referenced earlier examined whether public benefit from increasing regulation outweighed the higher real cost of housing and concluded that this is likely not the case. Instead, those who benefit from regulation have greater influence in the local political process and policymakers have an inflated view of the benefits and underestimate the costs of regulation.

In the federal context, I can give one example of this. Under HUD's National Environmental Policy Act regulations, nearly every program, from FHA loans to disbursing proceeds of CDBG and HOME Program grants, requires a governmental environmental review and notification process. There are thousands, if not tens of thousands, of these each year. Over the past six years, this process, which in each case adds many months and thousands of dollars to the cost of the housing projects which are involved, has resulted in a grand total of four environmental impact statements being deemed to be required. And most of those related to Rental Assistance Demonstration

projects which are themselves usually reconstructions of public housing projects in dense urban areas; it is hard to conceive that these are, in the abstract, the sort of project that would actually have broad scale environmental concerns. But whatever the benefit of these environmental impact statements, we have otherwise imposed enormous costs across the housing sector, at least insofar as any federal dollars were concerned. As I will discuss in a moment, that is one of the reasons that implementation of the National Environmental Policy Act ("NEPA") needs to be reconsidered broadly.

In many cases, it is not the requirements or expense of the red tape itself directly that is the chief impediment but rather the enormous cost in time which these cumulatively impose. For projects costing in the hundreds of thousands to many millions of dollars, these extended timetables imposed by otherwise not individually unreasonable government objectives collectively impose enormous costs. First, they impose costs for professionals and for reviewing and coordinating them. Second, there is the time value of money. Third, and perhaps most importantly, they impose the cost of much more risk. Simply put, bad things can happen during delay, such as increased costs, higher interest rates, land sellers who lose patience, investors who find other opportunities, and downturns in the economic cycle. This all especially affects smaller projects, where regulatory costs are fixed and high relative to the project size and a small increase in risk turns profit to loss. And the threat of that means nothing gets done.

As I noted in July, much of the growth in regulation has occurred since individual and small business real estate investors were economically pushed out of the market by the 1986 Tax Act. Indeed, the Reagan 1986 Tax Act brought us the low-income housing tax credit, a temporary provision at the time, which was intended to help offset the recognized impact of effectively taking individual and small business investors out of the residential rental real estate market. While this is multifamily rental real estate, items that affect its cost and availability have a direct impact on the cost of single-family homes, as these serve as functional equivalents for many persons. Thus, lower multifamily rental rates generally result in lower housing costs and vice versa.

The most problematic tax provision is the so-called passive activity loss limitation contained in Section 469 of the Internal Revenue Code. This essentially precludes anyone, other than a "widely-held C corporation", which typically means a public corporation, from using "passive losses", which include any losses generated from real estate, primarily through depreciation, to offset either active income or so-called portfolio income, which would include dividends and capital gains. There is an exemption for "real estate professionals" but that is only someone who essentially is involved full time in the real estate business as a developer or broker – usually the people who are actually looking for investors and are not frequently the principal investors themselves.

Further, this cordoning off of individual investors located in the same communities they would in many cases be investing in has skewed development in the United States to larger projects and larger cities. Stated most clearly, a real estate investment fund in Columbus, Ohio has little interest in participating in the development of small-scale market-rate housing development in Columbus, Nebraska.

Thus, my first and principal suggestion, especially as the Congress turns its attention to considering the expiration of the Tax Cut and Jobs Act, is to restore the ability of individual investors and closely held businesses to invest in local residential real estate. Specifically, I recommend that passive loss limits and other related impediments to investment in residential real estate be repealed with respect to those individual investors and closely held businesses, at least if investing within, say, 50 miles of the home or principal business office of such individual or business.

Second, the following are some of those Lilliputian pieces of red tape on the federal level which could be "snipped":

1. Eliminate most, or perhaps all, HUD programs from the coverage of NEPA. Under the revised definition contained in the Fiscal Responsibility Act of 2023, they simply do not meet the definition of a "major federal action". This is because HUD does not control the location or nature of the projects, but instead simply sets broad parameters for what it will finance. Moreover, it is difficult to conceive that NEPA, primarily aimed at nuclear power plants, hydroelectric dams, canals and air bases, should instead be deemed to be applicable to providing some of the financing to a private party for 80 apartment units in the middle of a city block. This doesn't mean that any of the substantive environmental requirements change but only the bureaucratic process of notice and review does.

Courts have held the Council on Environmental Quality regulations, on which the regulations of HUD and every other federal agency are based, were themselves unconstitutional. The current Administration has directed that those rules be withdrawn. This presents a clear field for better regulation by HUD and other federal agencies that are involved in similar housing programs to remove one of the greatest federal regulatory costs to the programs which they ostensibly support.

2. Encourage HUD and the Department of Defense to get on the same page to permit FHA Section 221(d)(4) and 223(f) financing to be used for projects which are located on excess federal land that are otherwise part of military bases and which are leased to private entities. The beauty of this is that literally no legislative or regulatory action is needed. The Department of Defense has clear authority to enter into ground leases and HUD has the ability to finance projects on leased land. It just happens HUD has never done this for land leased from, yes, the same federal government which it is a part of. And DoD needs to recognize that, as the party taking the credit risk, HUD needs a say on various items under the lease. This is one of the clearest and cleanest ways that we can use federal lands to support increasing the housing supply. Other avenues have many, many strands of red tape; believe me, we looked at this very hard at Secretary Ben Carson's direction when I was General Counsel of HUD. It is, practically speaking, impossible to effect in a broad or rapid way. Moreover, there is a great need for housing in areas surrounding military bases for service members and their families. The private market can do this at a fraction of what it costs for the Department of Defense to build its own housing. This one is a no-brainer and after more than two years of trying to get two

federal agencies on the same page about this, I hope that incoming leadership will be able to do this.

3. Abolish so-called mixed wage decisions with respect to the application of the Davis-Bacon Act to residential development. Treat all residential development as simply that – residential without dividing the project up into subsets creating incredible complexity and cost for builders. Note that this occurs simply through (likely unenforceable) administrative fiat at the Department of Labor and not even regulation or official guidance. Thus, it can readily be rescinded.

4. Withdraw HUD's policy concerning limitations on criminal background checks for rental tenants -- the so-called "Check the Box Rule". This was implemented simply by a memorandum of the General Counsel of HUD during the Obama administration without any administrative process, and now is in clear contravention of Supreme Court guidance on disparate impact. Further, the Biden Administration brought enforcement actions and published further sub-regulatory guidance broadening its scope. It makes operating rental properties more costly, especially with respect to liability insurance, and increases risk of crime to other tenants.

5. Reconsider the scope of limitations on development imposed by habitat restrictions related to threatened and endangered species, such as the northern long-eared bat. Its covered habitat is most of the eastern half of the continental United States. It precludes cutting trees for significant parts of the year, thus affecting thousands of projects. And in particular, the trees that are especially off limits to being cut are dead trees which are likely to constitute a safety hazard to the humans near them.

6. Review and streamline HUD site and neighborhood standards regulations. These are based on 50-year-old notions of what land use planning should be. They are, in effect, an additional federal zoning layer. Sec. Turner's recent recission of the Affirmatively Furthering Fair Housing regulations is a step in the right direction.

7. Improve the low-income housing tax credit. This would include increasing the amount of available credit, lowering the required threshold to obtain tax credits in conjunction with private activity bond financed projects from 50% to 25% and, generally, simplifying the credit. Regarding simplifying the credit, unbundling it from the enormous complexity of partnership tax allocations would result in a distinct savings in transaction costs. The "Allocation by Agreement" model works well for many state low-income housing tax credits and could be used on the federal side as well with no economic changes but a distinctly simpler approach. Proposed changes in pending legislation are generally all good but they are incremental. If Congress really wants to address the broad scale housing issue, it is time to be bold.

8. Review generally any "add on" requirements to programs which impede the speed or efficiency with which they can be implemented. Examples would be incentives for construction which require union labor or specific domestic content, requirements for construction which impose specific climate or energy requirements, childcare requirements for employers, particularly precise tenant targeting requirements, or

general requirements that impose upon private business the obligation to operate under bureaucratic norms (more policies and more paperwork).

9. Provide incentives and penalties to states to encourage them to set limitations on the amount of local regulation on housing. The focus on action at the state level is important for several reasons. First, it is simply more manageable than trying to address the huge number and variety of situations across this enormous and varied nation. Second, the problems often occur in particular communities where regulations are intended to be a barrier against people moving in from relatively nearby. States are more responsive to all of those voters and not just the ones inside the regulatory walls. Third, this better preserves federalism, albeit not perfect, and has less risk of micromanagement from Washington, D.C.

10. Have HUD's excellent Office of Policy Development and Research study and quantify the cost, in terms of time itself but especially increased risk, of regulatory delays on housing production.

Thank you for this opportunity to bring these thoughts and issues before you. I look forward to your questions and the opportunity to hopefully provide further insights into this crucially important but immensely complex issue.